United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

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74-1272

IN THE

United States Court of Appeals
FOR THE SECOND CIRCUIT

JEFF SIMON, as Custodian for GAIL NINA SIMON, Under the New York Uniform Gifts to Minors Act,

Plaintiff-Appellant,

vs.

THE NEW HAVEN BOARD & CARTON COMPANY, INCORPORATED, *et al.*,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF CONNECTICUT

BRIEF OF DEFENDANTS-APPELLEES

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Statement of the Issue

After finding from the evidence that The New Haven Board & Carton Company ("New Haven"), was not damaged, did the Court err in entering judgment for the defendants without reaching the question of whether defendants had violated state or federal law?

Statement of the Case

This derivative action by a stockholder of New Haven arose out of the merger in early 1964 of New Haven and sev-

eral Florida companies (the "Miami" companies) which were wholly owned by the defendants Leon, Morton and Dorothy Simkins and their families. The second amended verified complaint, Appendix B, charges in Count I that the defendants Edwin W. Miller, Sterling R. Chatfield and William B. Gumbart, directors of New Haven at the time of the merger, breached their fiduciary duties under Connecticut law in connection with the merger* and in Count II that all defendants violated § 10(b) of the Securities Exchange Act of 1934 [15 U.S.C. § 78j(b)] and Securities and Exchange Commission Rule 10b-5 (17 C.F.R. § 240.10b-5) in connection with the issuance on February 12, 1964, of certain written material to New Haven stockholders prior to the stockholders' meeting of February 28, 1964, at which the merger was approved.

Plaintiff's sole claim under both federal and state law was for monetary relief. *Simon* v. *New Haven Board and Carton Co., Inc.*, — F. Supp. —, Civil No. 10,425, mimeographed opinion at Appendix p. 140 (S-5), (D.Conn, January 8, 1974) (hereinafter cited as the "Opinion"); Trial Transcript pp. 832, 1281-1283, 1285-1287. At trial plaintiff abandoned an earlier claim for rescission and other relief. *Id.* ("The plaintiff relies solely upon a claim for damages and an accounting for profits by the defendants." Trial Transcript p. 832.)

As Judge Newman found, Opinion, Appendix p. 138 (S-3), New Haven was faced with a "bleak financial picture"

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* Plaintiff originally claimed in Count I that all defendants violated state law. He subsequently limited this claim to the three directors who resided in Connecticut after it became apparent that the District of Connecticut was not a proper venue for the assertion of such a claim against the other directors. See "Defendants' Motion to Dismiss for Lack of Jurisdiction and Improper Venue" filed June 26, 1964, and Judge Zampano's Order with respect to the same filed on May 21, 1965.

prior to the merger. It had experienced heavy losses for five successive years, retained earnings of \$2 million in 1959 had dwindled to just over \$¼ million by 1963, and the market price of the company's stock had dropped significantly. *Id.* A succession of management changes had failed to stop New Haven's decline. The Simkins acquired control of New Haven in 1963 and, after major changes in management and operations, the Miami companies and New Haven merged in an effort to overcome New Haven's continuing problems, especially a poor working capital position which, among other things, prevented the purchase of new machinery. *See* Trial Transcript pp. 963, 965. Subsequent to the merger, New Haven prospered. Opinion, Appendix p. 136 (S-1).

The merger terms were set by dividing the then current bid price for New Haven shares, \$4.50, into the value of the Miami shares, which had been determined by an independent appraisal to be \$6,200,000. This computation produced 1,377,774 as the number of New Haven shares to be issued in exchange for the Miami shares. Opinion, Appendix pp. 138-139 (S3-4).

On February 14, 1964, a packet of materials, including the 1963 annual report, a proxy statement, and a notice of the annual and special meeting, was sent to the New Haven stockholders. Appendix, Parts E & F. Plaintiff based his 10b-5 claims on alleged misrepresentations and omissions in these materials, especially on the alleged non-disclosure of a "turnaround" which plaintiff claimed occurred during the three months ending December 31, 1963, the first quarter of New Haven's 1964 fiscal year.

Plaintiff's case centered on this alleged turnaround. His expert, Dr. Bellemore, testified that disclosure of this alleged turnaround would have provided a basis on which New Haven shareholders could have concluded that the

value of New Haven shares at the time of the merger was not \$4.50 per share, but \$8.62½ per share. Plaintiff claimed that New Haven was damaged in two ways (a) because at a value of \$4.50 per share New Haven issued too many of its shares for the Miami shares (i.e. New Haven paid too much) and (b) because New Haven lost the opportunity to sell those "extra" New Haven shares at the increased post-merger market price. Defendants' expert, Dr. Hunt, concluded, after an analysis which is explained in detail in the Court's opinion, that \$4.50 per share was not less than the price reasonably to be paid as the fair value of the New Haven shares issued in the merger.

Judge Newman found Dr. Hunt's testimony far more realistic and persuasive than Dr. Bellemore's. Judge Newman's analysis of the testimony of each and his reasons for accepting Dr. Hunt's testimony over Dr. Bellemore's are set forth in detail in the opinion and will not be repeated here.

Judge Newman, having accepted Dr. Hunt's testimony, came "to the firm conclusion that even if defendants bear the burden of proof on state claims, the New Haven shares issued at the time of the merger did not have a fair market value in excess of the merger price of \$4.50 per share." Opinion, Appendix pp. 157-158 (S22-23). He further found that "the issuance of the 1,377,774 shares valued at \$4.50 per share caused no damage whatever to the corporate integrity of New Haven. There was no evidence to show any diminution in the Company's capacity, as a result of the merger ratio, to attract capital or loans. On the contrary, the merger vastly improved the Company's financial structure and operating capability." Opinion, Appendix p. 142 (S-7). In short, Judge Newman found from the evidence that New Haven sustained no damage. Accordingly, he held that since such "conclusion defeats all of plaintiff's claims for damages and since the absence of any damages

defeats both of plaintiff's causes of action, judgment will enter for the defendants denying all of plaintiff's claims for relief." Opinion, Appendix, p. 158 (S-23).*

Summary of Argument

Judge Newman found from the evidence that New Haven was not damaged and entered judgment for the defendants without reaching the question of whether defendants had violated state or federal law. The Court was correct. It is elementary that proof of damage to the corporation is an essential element of a stockholder's derivative action. Moreover, *Mills* v. *Electric Auto-Lite Co.,* 396 U.S. 375 (1970) does not require, as plaintiff claims, that the Court decide whether there has been a violation even if the corporation is not damaged.

ARGUMENT

I.

Damage to New Haven Was An Essential But Missing Element of Plaintiff's Claim.

In *Hoover* v. *Allen,* 241 F. Supp. 213 (S.D.N.Y. 1965), plaintiff claimed that the defendant directors engaged in a scheme to depress the value of the corporation's stock, that

* Plaintiff erroneously claims that Judge Newman failed to find the facts specially and state separately his conclusions of law thereon as required by Rule 52(a). Judge Newman's findings of fact and conclusions of law were included in his opinion, as authorized by Rule 52(a), and they were supported by the evidence and sufficient to form a basis for his decision. See *Petterson Lighterage & Towing Corp.* v. *New York Central R.R.,* 126 F.2d 992, 996 (2d Cir. 1942). Judge Newman did not make a finding with respect to the alleged violations of state and federal law because such a finding was not necessary to his decision. See 5A *Moore's Federal Practice,* ¶ 52.06[1], pp. 2713-15 (1974 ed.) ("And the court need not find on every issue requested, but a finding of such essential facts as lay a basis for the decision is sufficient.")

the corporation then purchased the stock at the artificially depressed price thereby giving defendants control of the company, and that, thereafter, defendants committed acts of waste. In granting summary judgment for the defendants, Judge Herlands held that plaintiff's claim was fatally defective because the corporation had not been shown to have been damaged as a result of defendants' alleged violation of 10b-5. He said:

> For purposes of this motion, it will be assumed that the price at which the Company purchased its stock was artificially depressed below actual value as the result of misleading statements knowingly made pursuant to a scheme on the part of the defendants to place control of the Company in the hands of defendant Ludwig. Such would satisfy the *fraud* requirement of section 10(b).
>
> Because, however, the Company *purchased,* rather than sold, at the fraudulently depressed price, the sellers and not the Company were the "victims" of the alleged fraud. List *v.* Fashion Park, Inc., 340 F.2d at 462-463. Indeed, the immediate effect of the Company's purchasing at a price below value was to benefit, rather than injure, the Company.
>
> Consequently, the Company has no cause of action under section 10(b) predicated solely upon its purchase of its stock at a fraudulently lowered price. It follows that a derivative action under section 10(b) premised on this theory cannot stand.
>
> (at 227)
>
> * * *
>
> Moreover, even if fraudulent acquisition of corporate control were found to constitute an injury to the Company under section 10(b), damages resulting from acts of corporate waste committed by those who acquired corporate control by means of the fraud would not constitute damages for which federal relief may be sought under section 10(b).
>
> (at 229)

Smith v. *Murchison,* 310 F.Supp. 1079 (S.D.N.Y. 1970), is to the same effect. In that derivative action, plaintiffs claimed that the defendant directors obtained an artificially high price on the sale of their stock in the corporation by means of a scheme violative of 10b-5 which involved, among other things, fraudulently causing the corporation to purchase its own stock to bolster the price. Judge Bryan, in holding that no claim was stated under 10b-5 because there was no damage to the corporation, said:

> In order to state a claim under Rule 10b-5, however, it must appear not only that a purchase or sale took place, but that there was a loss and that the loss flowed directly from the purchase or sale. [cites omitted] Here, plaintiff alleges neither damages nor sufficient causal connection between the corporate purchase of securities and the premium sought to be recovered. It is not alleged that the price of the stock defendants caused Alleghany to purchase declined or that Alleghany suffered any loss or damage whatsoever by reason of such purchases.
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> (at 1084-85)

There are a number of other cases reiterating this well-established principle. For example, in *Cohen* v. *Colvin,* 266 F.Supp. 677, 683 (S.D.N.Y. 1967), the Court said:

> . . . [I]n order to sustain an action under Section 10(b), a plaintiff must allege that he was damaged as a result of the action of the defendants. . . . Here, all indications point to the fact that rather than sustaining damages, the corporation benefited from the actions of the defendants.

See also, *Ohio Drill & Tool Co.* v. *Johnson,* 361 F.Supp. 255, 260-261 (S.D. Ohio 1973), where the Court said:

> Stockholder derivative actions are not personal in nature or purpose. Under both the Securities and

> Exchange Act of 1934 and the common law of Ohio, they are, instead, actions to enforce the right of a corporation when it is harmed by the fraud or negligence of its officers and directors. Thus, an essential element of the derivative action is proof that the corporation has in fact been damaged by the actions of such officers and directors. The mere failure to comply with business formalities, negligent or shoddy activities by corporate officers, even actual fraud—these are not actionable in the absence of proven economic detriment to the corporation's interest.

To the same effect are *Lewis* v. *Bogin*, 337 F.Supp. 331 (S.D.N.Y. 1972), *Dasho* v. *Susquehanna Corp.*, 461 F.2d 11 (7th Cir.), *cert. denied* 408 U.S. 925 (1972), and *Swanson* v. *American Consumers Industries, Inc.*, 475 F.2d 516 (7th Cir. 1973), all of which are discussed in detail under Point II *infra.*

This well-established principle that damage to the corporation is an essential element of a derivative claim applies with equal force to plaintiff's state law claim (Count I) against the three Connecticut directors, *cf. Richland* v. *Crandall*, 262 F.Supp. 538 (S.D.N.Y. 1967). In this connection, it should be noted that plaintiff never claimed, and there was no evidence, that any of these three outside directors had any personal interest in the merger which would bring them within the ambit of § 33-323 of the Connecticut General Statutes or impose on them the burden of proving that the merger was fair to the corporation. See *Osborne* v. *Locke Steel Chain Co.*, 153 Conn. 527, 534-535 (1966).* Also, since the state law claim (Count I) was not

* Even if the situation were otherwise, cases such as *Cathederal Estates* v. *Taft Realty Corp.*, 157 F.Supp. 895 (D. Conn. 1954), aff'd 228 F.2d 85 (2d Cir. 1955) and 251 F.2d 340 (2d Cir. 1957), and the other earlier Connecticut cases on which plaintiff relies, would not be applicable because § 33-323, which was enacted after those cases, was designed to and did supplant those cases. See Cross,

asserted against the Simkins, it is wholly inappropriate for the plaintiff to claim that Judge Newman committed error by failing to place the burden of proof on the state law issues on the Simkins or that the Simkins failed to sustain their burden of proof under state law.

Plaintiff argues that Judge Newman erroneously applied a restricted theory of damages and ignored other appropriate theories. This belated claim cannot stand a close analysis. Plaintiff's sole claim of damage to New Haven was that the exchange ratio was unfair and that as a result New Haven issued too many of its shares for the Miami shares and lost the opportunity to sell those "extra" New Haven shares at the increased post-merger price. Plaintiff's evidence was limited to the value of the New Haven shares at the time of the merger and to the alleged unfairness of the exchange ratio. His expert, Dr. Bellemore, testified to nothing else; and plaintiff called no other witnesses except defendant Leon Simkins, whose testimony did not relate to damages in any way. As plaintiff's counsel stated at the conclusion of the trial: ". . . [I]t is a case relating to fairness of ratio" (Trial Transcript p. 1289). No other claim or evidence of damage was presented. Accordingly, plaintiff's reliance on cases such as *Affiliated Ute Citizens* v. *United States,* 406 U.S. 128 (1972), *Gerstle* v. *Gamble-Skogmo, Inc.,* 478 F.2d 1281 (2d Cir. 1973), *Zeller* v. *Bogue Electric Mfg. Corp.,* 476 F.2d 795 (2d Cir.), *cert. denied,* 42 U.S.L.W. 3226 (Oct. 9, 1973), *Janigan* v. *Taylor,* 344 F.2d 781 (1st Cir.), *cert. denied,* 382 U.S. 789 (1965), and *Myzel* v. *Fields,* 386 F.2d 718 (8th Cir. 1967), *cert. denied,* 390 U.S. 951 (1968) is totally misplaced. Here, there was no claim or evidence that defendants reaped

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Corporation Law in Connecticut, § 6.8, pp. 296-307 (1972). In addition, even if § 33-323 applied to the three Connecticut directors, Judge Newman found that they sustained the burden of proving—if they ever had a such a burden—that the transaction was fair to the corporation.

windfall profits at the expense of New Haven, that New Haven could have obtained a higher merger price, or that New Haven sustained any other damage, consequential or otherwise. Plaintiff had ample opportunity to present evidence that New Haven was damaged in some way other than by the alleged unfairness of the exchange ratio, if any such evidence existed, but he failed to do so. Moreover, there is no merit to plaintiff's claim that, because the complaint asked for an accounting for profits and other equitable relief, Judge Newman was required to decide whether violations had occurred even if he found no damage to New Haven. There simply was no evidence that the defendants damaged New Haven or profited themselves at the expense of New Haven in any way other than by setting the allegedly unfair exchange ratio. To the contrary, the evidence showed that the defendants took actions which they were not required to take to benefit New Haven at their own expense: Leon and Morton Simkins served without salary, Appendix p. 74 (F-16), Opinion, Appendix p. 15 (S-15), and all of the Simkins agreed voluntarily not to accept dividends which were distributed to all other New Haven shareholders. (Trial Transcript pp. 929-931.) In addition, plaintiff's present claim that Judge Newman was required to decide whether there had been violations and then, even if no damage to New Haven was found, to fashion some form of equitable relief, runs directly counter to the limited relief plaintiff sought. As plaintiff's counsel stated on trial:

> *Mr. Scharf*: . . . The plaintiff relies solely upon a claim for damages and an accounting for profits by the defendants.
>
> *The Court*: All right.
>
> *Mr. Scharf*: I just wanted to make that clear.
>
> (Trial Transcript p. 832)

The evidence simply failed to support plaintiff's claim that New Haven was damaged or was entitled to any relief. Plaintiff, having had a full opportunity to adopt his theories and present his case based on those theories, should not now be permitted a second chance simply because, now that he has lost, he wants to proceed on a different theory and to seek different relief.

II.

Mills v. *Electric Auto-Lite Co.*, 396 U.S. 375 (1970) Did Not Require The Court To Decide Whether There Were Violations.

Plaintiff places great reliance on *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375 (1970). He claims that *Mills* required Judge Newman to pass on the question of violation and, if violations were shown, to fashion some kind of relief and, at the very least, to award plaintiff attorneys' fees even if the evidence did not show that New Haven was damaged in any way. Plaintiff has misread and misapplied *Mills*.

In *Mills*, minority stockholders sued derivatively and on behalf of other stockholders to set aside a merger of their corporation and another corporation and to obtain "such other relief as might be proper." The plaintiffs claimed that the proxy solicitation for the merger was misleading in violation of Section 14(a) of the 1934 Act and the rules thereunder. The District Court, upon plaintiffs' motion for summary judgment, ruled as a matter of law that the claimed defect in the proxy statement was a material omission, and, after a hearing, concluded that approval of the merger could not have been achieved without the votes of minority stockholders and that, therefore, a causal relationship had been shown between the finding of a Section 14(a) violation and the alleged injury to the plaintiffs. The

District Court entered an interlocutory judgment in favor of plaintiffs and referred the case to a master for consideration of appropriate relief. On interlocutory appeal, the Court of Appeals for the Seventh Circuit affirmed the conclusion that the proxy statement was materially deficient but held that the granting of summary judgment with respect to causation was erroneous and that it was necessary to resolve at trial whether there was a causal relationship between the deficiency in the proxy statement and the merger. Finding that causation could not be directly established because of the impracticalities of determining how many votes were affected, the Court ruled that the issue was to be determined by proof of the fairness of the terms of the merger, and that, if the defendants could prove that the merger was fair to the minority stockholders, the trial court could conclude that a sufficient number of stockholders would have approved the merger regardless of the deficiencies in the proxy statement.

The Supreme Court disagreed with the Court of Appeals. In reversing, the Court said:

> Where there has been a finding of materiality, a shareholder has made a sufficient showing of causal relationship between the violation and the injury for which he seeks redress if, as here, he proves that the proxy solicitation itself, rather than the particular defect in the solicitation materials, was an essential link in the accomplishment of the transaction. This objective test will avoid the impracticalities of determining how many votes were affected, and, by resolving doubts in favor of those the statute is designed to protect, will effectuate the congressional policy of insuring that the shareholders are able to make an informed choice when they are consulted on corporate transactions. (396 U.S. at 385)

The Court went on to say that its conclusion that the plaintiffs had established their case by showing that proxies

were obtained by means of a defective proxy statement implied nothing about the form of relief to which they might be entitled. The Supreme Court noted the possibility of setting aside the merger or granting other equitable relief, but agreed with the Court of Appeals that "nothing in the statutory policy 'requires the Court to unscramble a corporate transaction merely because a violation occurred.'" The Court referred also to the possibility of monetary relief, but said:

> . . . [W]here, as here, the misleading aspect of the solicitation did not relate to the terms of the merger, monetary relief might be afforded to the shareholders only if the merger resulted in a reduction of the earnings or earnings potential of their holdings. In short, damages should be recoverable only to the extent that they can be shown. If commingling of the assets and operations of the merged companies makes it impossible to establish direct injury from the merger, relief might be predicated on a determination of the fairness of the terms of the merger at the time it was approved. (396 U.S. at 388)

Finally, the Supreme Court held that the plaintiffs, having established their cause of action by a successful motion for summary judgment, were entitled to an interim award of litigation expenses and reasonable attorneys' fees incurred in proving the violation because they had conferred a benefit on the corporation and the stockholders. In reaching this result, the Court said that attorneys' fees are awarded on a benefit theory, usually in a class suit where a benefit has been bestowed upon the class by plaintiff's attorneys, and are awarded to avoid the unjust enrichment of those who have benefited by the relief granted. 396 U.S. 390, 392, 393-394. Such fees should be awarded in securities litigation only where "special circumstances" exist, 396 U.S. 391, such as "where a plaintiff has success-

fully maintained a suit, usually on behalf of a class, that benefits a group of others in the same manner as himself." 396 U.S. 392. The Court then cited cases "where the litigation has conferred a substantial benefit on the members of an ascertainable class. . . ." 396 U.S. 393-394. These cases included a declaratory judgment that an election of directors was invalid, 396 U.S. 395-396, cancellation of shares by a judgment which enhanced the value of the shares held by the benefited class, 396 U.S. 394, and termination of a voting trust thereby giving all certificate holders the right to vote. 396 U.S. 395. In each case cited a benefit was in fact conferred. The Court said that while the benefit conferred could be non-monetary, it would nevertheless have to be substantial; and for this proposition it quoted the Supreme Court of Minnesota's opinion in *Bosch* v. *Meeker Cooperative Light & Power Ass'n.,* 257 Minn. 362, 366-367 (1960):

> Where an action by a stockholder results in a substantial benefit to a corporation he should recover his costs and expenses. . . . [A] substantial benefit must be something more than technical in its consequence and be one that accomplishes a result which corrects and prevents an abuse which would be prejudicial to the rights and interests of the corporation or affect the enjoyment or protection of an essential right to the stockholder's interest.
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> (quoted at 396 U.S. 396)

Mills is distinguishable from the present case in a number of significant respects. *Mills* was a class action and a derivative action. The present case is solely a derivative action. In *Mills* plaintiffs claimed that the proxy statement was defective because it did not comply with Section 14(a) and the proxy rules and they asked that the merger be set aside for this reason. They did not claim that the corporation sustained any monetary damage as a result

and they did not ask for monetary relief. In the present case the plaintiff claimed that defendants were guilty of fraud in violation of Section 10(b) and Rule 10b-5 and that the corporation sustained monetary damage as a result. Here, plaintiff asked for monetary relief only; he did not ask that the merger be set aside. In *Mills* the plaintiffs obtained a partial summary judgment that defendants had not complied with Section 14(a) and the proxy rules. In the present case plaintiff did not move for partial summary judgment and the matter proceeded to trial on all issues. In *Mills* the plaintiffs by their successful motion for summary judgment conferred a benefit on the stockholders they represented, the nature and extent of which was to be determined after a hearing on the form of relief to be awarded. Here, plaintiffs sought monetary relief for New Haven and the evidence presented on the trial of all issues failed to demonstrate that the corporation was entitled to any such relief.

The Supreme Court in *Mills* did not hold, as plaintiff claims, that, even if no damage as claimed has been shown, the District Court must decide whether the securities laws have been violated and, if violations are found, fashion some kind of relief, and, at the very least, award plaintiff attorneys' fees. Certainly the cases decided subsequent to *Mills* have not so interpreted it.

In *Lewis* v. *Bogin,* 337 F.Supp. 331 (S.D.N.Y. 1972), a derivative and class action, plaintiffs claimed that defendants had violated Sections 10(b) and 14(a) and state law in connection with a merger transaction and they asked that the merger be declared void, their corporation be reconstituted, that defendants be required to account to the corporation for their profits, and that defendants pay damages to the corporation and its stockholders. The value of the corporation's stock at the time of the merger had been determined in a prior state court proceeding to have been $18.50

per share, the precise amount which the plan of merger provided for payment to the stockholders, and that value was not contested in the district court proceedings. Defendant moved for summary judgment on the grounds that (a) the necessary causal relationship between the alleged violations of Section 10(b) and 14(a) could not be established and (b) neither the corporation nor the stockholders were damaged as plaintiffs claimed. Judge Lasker, in granting defendant's motion, held that it was not necessary to pass on the question of causation because it was clear that neither the corporation nor the stockholders were damaged. He said:

> We find that on the material facts as to which there is no genuine issue the plaintiff has failed to establish damage to the corporation, to herself, or the class of minority stockholders as a result of the alleged misrepresentations in and omissions from the proxy statement. Accordingly, defendants' motion for summary judgment is granted as to those allegations
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> (at 333)

With respect to the "causation" issue, Judge Lasker noted that there was a difference of opinion as to whether *Mills* applies even where the defendants do not require the votes of minority stockholders for merger approval and said:

> Nevertheless, however piquant the subject and the different views of it may be, since we find, as stated below, that neither the stockholders nor CN have suffered damage, we need not and we do not determine whether the facts here "satisfy the causation requirement."
>
> (at 337)

Judge Lasker also held that plaintiff could not defeat defendants' motion for summary judgment by asserting damage

theories that were not claimed in the complaint or supported by the record. He said:

> On the record before us we find that the public stockholders of CN were not damaged by the merger or as a result of the facts alleged in the complaint. On the voluminous evidence submitted by defendants in support of their motion, which is uncontested by the plaintiff and which we have studied in detail, we conclude that the value of the stock on the date of the merger was $18.50, *taking into account all the factors which plaintiff claims were omitted from the proxy statement.* As indicated above, the appraiser's lengthy report, and his determination that the CN stock's fair value was $18.50, based on exhaustive hearings at which the appraisal Respondents presented all the facts and arguments which plaintiff here presents, and confirmed by the State Court, reflected the true value of CN's intangible assets and its Butterick stock *however those values may have been set forth in the proxy statement.* And even if it be assumed, as argued by plaintiff, that because the merger is void under § 29(b) of the Act the public shareholders are entitled to rescissional or restitutional damages, they are nevertheless not entitled to any element of value attributable to CN's post-merger sale of its Butterick stock, since no claim is made (and the facts do not establish) that any misrepresentation occurred as to that sale. In other words, as to that sale there is no claim (or factual basis for a claim) that there was a violation of § 10 (b) or § 14(a).

Such decisions as Speed v. Transamerica Corporation, 235 F.2d 369 (3d Cir. 1956), Gerstle v. Gamble-Skogmo, Inc., supra, and Myzel v. Fields, 386 F.2d 718 (8th Cir. 1967), do not require a contrary conclusion. In those cases the complaint alleged and the proof established that the defendants knew, or had reason to believe, that the merging corporation's property would be sold at a higher value than that

set forth in the proxy statement. Such is neither the claim nor the fact in the instant case. This substantial distinction alone makes *Speed, Gerstle* and *Myzel* inapplicable here. But beyond that, in those cases the merger plans did not provide for payment to the dissenting shareholders in an amount proven—as here—to be the actual value of their stock, taking into account the misrepresentations or omissions of which they complained.

* * * We find also that CN was not damaged as a result of the merger or its consequences. CN survived the merger, and neither profited nor lost by it.

(at 337-38)
(emphasis in the original)

Dasho v. *Susquehanna Corp.*, 461 F.2d 11 (7th Cir.) *cert. denied* 408 U.S. 925 (1972), is also relevant. In that derivative and class action plaintiffs stockholders of Susquehanna claimed that defendants had violated Section 10(b) in connection with the merger of Susquehanna and American Gypsum Company. They alleged that Susquehanna had been harmed because the exchange ratio was unfair and because prior to the merger defendants caused Susquehanna to purchase 222,107 of its own shares at an excessive price. After an extensive trial, the district court entered judgment for the defendants on all claims. The main issue on appeal was whether plaintiffs had a Seventh Amendment right to a jury trial. The Court held that, in light of the then recently decided *Ross* v. *Bernhard,* 396 U.S. 531 (1970), they did. But before deciding whether to remand for trial, the Court said that it must satisfy itself that "the record contains evidence tending to prove that Susquehanna was deceived, that there was a causal connection between the deception and the purchase, *and that it was damaged thereby.*" 461 F.2d 27 (emphasis added.) The Court made it clear that the damage action could not continue unless there

was some evidence from which a jury could find damages. 461 F.2d 25, 27. "[U]nless the record contains evidence on which an award of damages could be based, a jury trial may be unnecessary . . . ." 461 F.2d 27. Finding nothing in the record to suggest that Susquehanna should not have been merged with Gypsum, or that a more favorable opportunity was lost because of the Gypsum merger, the Court concluded that the only way Susquehanna could have been injured was if the exchange ratio was unfair:

> For purposes of analysis we may assume that Susquehanna sold its own shares for a price of $10.75 per share and purchased Gypsum shares for a price of $5.65 per share [the exchange ratio.] If either the former price was too low, or the latter price was too high, and if no compensating adjustment in the other is appropriate, Susquehanna was damaged. In other words, if the exchange ratio was unfair to Susquehanna, it was injured by the merger.
>
> (461 F.2d 27)

The Court distinguished *Mills* on the ground that the plaintiffs there were seeking equitable relief (undoing of the merger) and not damages:

> There are two reasons why quotations of that language out of its context [the *Mills* conclusion at 396 U.S. 384-385 that no proof was required that the proxy defect actually had a decisive effect on the voting in order to establish causation] does not necessarily eliminate the causation issue in this case. In *Mills* the plaintiffs were seeking equitable relief, not damages as plaintiffs do here. In *Mills,* apart from any question of the fairness of the exchange ratio, plaintiffs sought to vindicate their right to be shareholders of a separate company rather than a larger, combined enterprise; here the merger itself was apparently unobjectionable and a damage award must, in effect, depend on a revision of the exchange ratio.

> Thus, although the *Mills* holding would seem to require a finding of "legal injury" caused by the violation, in this case that injury may not include any pecuniary loss.
>
> In short, we think *Mills* takes us this far: If plaintiffs prevail on the issue of materiality, they have also established that approval of the 1.9 to 1 exchange ratio was unlawfully obtained. But that approval caused Susquehanna monetary injury only if (a) Susquehanna would have been better off with no merger at all; or (b) a more favorable exchange ratio would have been available if there had been full disclosure. The first alternative is not supported by any evidence which has been called to our attention; the second requires an evaluation of the transaction from Gypsum's point of view as well as Susquehanna's. For if it were plain from the record that Gypsum's shareholders would not in any event have approved a merger on terms which required surrender of more than 1.9 of their shares for each Susquehanna share, then approval of those terms, even if unlawfully obtained, did not harm Susquehanna.
>
> (461 F.2d 30-31)
> (notes omitted)

The Court indicated that but for the Seventh Amendment right of plaintiffs to a jury trial of the issue, and the fact that there was evidence from which a jury could find the exchange ratio unfair, it would affirm the finding of the district judge:

> The district court found that the exchange ratio was fair. All the directors so testified, and plaintiffs offered no expert testimony to the contrary. The finding is further supported by the opinions of New York Hanseatic Corporation and Stone and Webster. Even though the finding is not clearly erroneous, indeed even if we would enter the same finding our-

> selves, it does not follow that the record contains no evidence from which a jury might have come to a different conclusion.
>
> (461 F.2d 27)

Thus, the Court of Appeals in *Dasho* held that the absence from the record of evidence from which a jury could find damage to the corporation would have defeated the cause of action either because the absence of damage by itself defeats the action or because without damage it makes it impossible for the plaintiff to establish the necessary element of causation.

In *Swanson* v. *American Consumers Industries, Inc.*, 475 F.2d 516 (7th Cir. 1973), the plaintiff, suing derivatively and for all other similarly situated stockholders, claimed that the defendant corporation employed manipulative and deceptive devices, including a deceptive proxy statement, in connection with a merger and reorganization of plaintiff's corporation. Plaintiff asked for rescission, damages, other suitable relief, plus attorneys' fees. After trial, the district court entered judgment for defendants. The district court found that the exchange ratio was fair and reasonable to the corporation and its stockholders and that, therefore, plaintiff was not entitled to monetary relief or to have the merger set aside. The Court also found that plaintiff had failed to prove reliance on the deceptive proxy or that there was any causal connection between any defects in the proxy and the merger. On appeal, plaintiff argued that he had satisfied the *Mills* test of causation by proving that the proxy statement used in connection with the merger was materially defective and that, therefore, since he had proved a violation, he was entitled to rescission, restitution, or other suitable relief, plus attorneys' fees. The Court of Appeals noted that *Mills* might not apply because the defendants had sufficient votes to effect the merger regardless of the minority votes:

> Insofar as plaintiff claims the merger itself was the injury, it may be that since ACI controlled a sufficient amount of shares to approve the merger regardless of the minority vote, causation between the deception and the injury has not been established.

The Court held, however, that it did not have to decide whether *Mills* applied because, even if plaintiff had proved a violation, he failed to show that he was entitled to the relief requested with respect to the terms of the merger. The Court said:

> The Supreme Court expressly reiterated this Court's statement in our decision in *Mills* that "nothing in the statutory policy 'requires the court to unscramble a corporate transaction merely because a violation occurred.'" 396 U.S. at 386, 90 S.Ct. at 622. Further, the Supreme Court directed that in fashioning retrospective relief, "the federal courts should consider the same factors that would govern the relief granted for any similar illegality or fraud" and that "[o]ne important factor may be the fairness of the terms of the merger." 396 U.S. at 386, 90 S.Ct. at 622. Here the lower court found that "the exchange ratio of five shares of Peoria stock for one share of ACI stock, which was established in the plan, was fair and reasonable to Peoria, to ACI, and to the shareholders of both." 328 F.Supp. at 807. We cannot say that this finding, supported by particularized factual findings largely based on credibility determinations, was "clearly erroneous" within the meaning of Rule 52(a) of the Federal Rules of Civil Procedure. Moreover, the lower court concluded that to require unscrambling "would be a grave injustice to the other shareholders of ACI." *Id.* Insofar as plaintiff shareholders seek relief in their derivative status, "while they do have a derivative right to invoke [Peoria's] status as a party to the agreement, a determination of what relief should be granted in [Peoria's] name must hinge on whether

setting aside the merger would be in the best interests of the shareholders as a whole." Mills, supra, 396 U.S. at 388, 90 S.Ct. at 623. The district court, exercising "the sound discretion which guides the determinations of courts of equity," (*id.* at 386, 90 S.Ct. at 622), made the foregoing finding that setting aside the merger would not be in the best interests of all shareholders, and we are not inclined to find an abuse of that discretion.

With respect to any monetary recovery to the plaintiff shareholders predicated on the terms of the merger, we will again assume that a causal connection is established between the false or misleading proxy statements and accomplishment of the merger. But as in Dasho v. Susquehanna Corp., 461 F.2d 11, 30 (7th Cir.), certiorari denied, 408 U.S. 925, 92 S.Ct. 2696, 33 L.Ed. 2d 336 (1972), although this "would seem to require a finding of 'legal injury' caused by the violation, in this case that injury may not include any pecuniary loss."

Applying the analysis of *Dasho,* approval of the sale of assets and reorganization caused plaintiff shareholders "monetary injury only if (a) [Peoria] would have been better off with no merger at all; or (b) a more favorable exchange ratio would have been available if there had been full disclosure." *Id.* at 31. The district court found that "Peoria, during and prior to ACI control, was not a viable entity; that Peoria was unable, financially, to exploit the market available to it and unable to obtain such financing as was necessary for conversion of the corporation into a viable entity." 328 F.Supp. at 806. This finding is supported by ample evidence, and hence it is clear Peoria would not have been better off with no merger at all. As to the availability of a more favorable exchange ratio upon full disclosure, there was simply a failure of evidence to support a monetary recovery. What suffices to show causation of a legal injury—the merger—does not automatically show plaintiffs suffered compen-

> sable monetary injury. "[D]amages should be recoverable only to the extent that they can be shown." *Mills, supra,* 396 U.S. at 389, 90 S.Ct. at 624.
>
> (at 519-20)
>
> * * *
>
> . . . [T]he allegations of unfairness in the complaint were not proved. The district court found that ACI paid full reasonable value for Peoria's assets and that the exchange ratio of five shares of Peoria stock for one share of ACI stock was fair and reasonable to Peoria and its shareholders. 328 F.Supp. at 807. This is a case where monetary relief is appropriately "predicated on a determination of the fairness of the terms of the merger at the time it was approved." *Mills, supra,* 396 U.S. at 389, 90 S.Ct. at 624. The lower court having concluded that the terms of the merger were fair and reasonable at the time of the transaction, and we having concurred with that conclusion, the plaintiffs are not entitled to a retrospective revision of the merger terms.
>
> (at 520)

The Court also found that, even though defendants did not need the votes of minority stockholders to effect the merger, the deceptive proxy statement might have caused some stockholders to approve the merger and thus lose their statutory appraisal rights:

> Whether or not causation should be taken as established between the deceptive proxy statement and the consummation of the merger, causation between the proxy statement and other injury claimed to have been suffered stands on an entirely different footing.
>
> (at 520)

Holding that "it is inescapable that plaintiff shareholders have proven all the elements required to impress liability

on defendants under Section 10(b) of the Securities and Exchange Act and the Commission's Rule 10b-5 for loss of their statutory appraisal rights", the Court said that the "appropriate remedy is to restore to the plaintiff shareholders the opportunity to receive cash rather than the ACI shares" and it directed how that was to be done. Also, because plaintiff had conferred a benefit, the Court held that he "is also entitled to reimbursement of reasonable attorneys' fees in an amount to be fixed by the district court, of course taking into account the modest recovery achieved, but cognizant that pecuniary benefit is not the sole criterion for the award of attorneys' fees" (at 521).*

The foregoing cases, all decided subsequent to *Mills*, demonstrate that the Court is not required to pass on the question of violation if the evidence fails to support the plaintiff's claims of injury or damage. These cases also show that the Court is not required to provide remedies for claims that were not pursued by the plaintiff and were not supported by the evidence. Moreover, as noted by the Court in *Dasho* v. *Susquehanna Corp., supra,* and *Swanson* v. *American Consumers Industries, Inc., supra,* where the claim is for monetary relief only (unlike the *Mills* case) it may be impossible for plaintiff to establish the necessary element of causation if the evidence fails to show any damage to the corporation. Also, as pointed out in *Swanson* v. *American Consumers Industries, Inc.*, the plaintiff is entitled to an award of attorneys' fees only if he has in fact conferred a benefit.

Finally, even if Judge Newman had found a violation, the result would still have been the entry of judgment for defendants. Here, plaintiff sought only monetary relief.

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* In the present case plaintiff sued derivatively only and not on behalf of other stockholders. In addition, in the present case stockholders had no statutory appraisal rights under Connecticut law. Accordingly, the above-quoted portion of the Court's opinion in *Swanson* is of no help to the plaintiff here.

And monetary relief could only be "predicated on a determination of the fairness of the merger at the time it was approved", *Mills, supra,* 396 U.S. at 389, because plaintiff's evidence was limited to the value of the New Haven shares at the time of the merger and to the alleged unfairness of the exchange ratio. Judge Newman rejected plaintiff's evidence and accepted defendants' evidence that the exchange ratio was fair to New Haven and that, therefore, New Haven sustained no damage. In these circumstances, even if Judge Newman had found a violation, he would not have awarded plaintiff the relief he requested; and since New Haven would have received no benefit whatever as a result of plaintiff's action, there would have been no basis on which to award attorneys' fees to the plaintiff.

Conclusion

The judgment should be affirmed.

Respectfully submitted,

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Due and timely service of three (3) copies of the within Brief *is hereby admitted this* 1st *day of* July *, 19*74

Attorney for

Copy Received, Date: 7/1/74

BOBROFF, OLCNOFF & SCHARF

Attys for: Plaintiff-Appellant